Re-Communalisation: The Impact of the In-House Privilege and National Public Pricing Law on European State Aid Law

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The re-communalisation of public services is an attractive opportunity for public authorities to fund and offset loss-making public undertakings within a municipal 'Querverbund'. On the other hand, it gives rise to conflicts with European State aid law that have often been neglected. This article aims to illustrate potential legal pitfalls in this context by reference to a case study, taking up an example of re-communalisation in the water management sector. Focussing on the existence of an advantage, it is discussed whether municipal authorities are entitled to rely on the in-house privilege under public procurement law in order to exempt themselves from the obligation to carry out transactions in line with normal market conditions. Closer attention is paid to the relevance of national public pricing law in and its impact on the notion of advantage under European State aid law: The article claims that the pricing of public contracts pursuant to national public pricing law on a cost-price basis is not an appropriate method to establish a transaction's compliance with market conditions.

I. Introduction

Throughout the European Union, public authorities are engaging in re-communalising the operation of public service tasks. Such re-communalisation is susceptible to involving illegal State aid, favouring municipal 'start-ups'. On the basis of a case study, potential legal pitfalls in this context will be illustrated. The case study deals with the re-communalisation of the operational management of the drinking water supply and effluent disposal services and involves two aid measures the compatibility of which with European State aid law has to be assessed: First, on the upstream level, the acquisition of a shareholding in a newly formed municipal company by a company 100% owned by the city. Second, on the downstream level, the assignment of the operational management of the water management services to the newly formed company by way of a contract, providing for a compensation calculated on the basis of cost prices pursuant to national public pricing law. Both transactions take place 'in-house'.

The legal assessment focusses on the existence of an advantage within the meaning of Article 107 (1) TFEU: The nature of the transactions as in-house procurement urges the question to what extent the in-house privilege under public procurement law affects the legal assessment under European State aid law: It is argued that a public authority is not entitled to rely on the in-house privilege when it is unable to demonstrate that the transaction was carried out in line with normal market conditions in order to rule out the existence of an advantage within the meaning of Article 107 (1) TFEU (Section III.2). The fact that the remuneration paid under the contract was calculated on the basis of cost prices, applying national public pricing law, requires a discussion of the impact of the pricing of public contracts in accordance with national public pricing law on European State aid law: Does national public pricing law provide for an appropriate method to establish...
compliance with normal market conditions (Section III.3)?

The article then presents a summary of the findings (Section III.5) and ends with a conclusion relating to the relevance of European State aid law in the context of re-communalisation on the more abstract level (Section IV). The exemption from a control under European State aid law as a compensation for Services of General Economic Interest (SGEI) is not dealt with in greater detail.

II. Case Study

Clearwater Ltd operates as a drinking water supply and effluent disposal company in the area of City C, reliably performing its services on a high technical level since 1992. On the basis of a contract, Clearwater Ltd provides its services on behalf of the Water-Association. The Water-Association is a public special purposes association located in City C. It is responsible for the public water supply and effluent disposal in the area of City C and its surrounding municipalities. In order to meet its statutory obligations, the Water-Association entered into a contract with Clearwater Ltd in 1992 to perform the aforementioned services.

With effect as of 31 December 2019, the Water-Association terminated the agreement with Clearwater Ltd based on resolutions concluded by the citizenship of City C and the Water-Association. From 1 January 2020 onwards, the Water-Association intends to re-communalise the operational management of the water management services: The drinking water supply and effluent disposal services within the area of the Water-Association’s responsibilities are being reascribed to City C.

For this purpose, a new company, Waterfall Ltd, was formed by the Water-Association and Municipal Holding Ltd. Waterfall Ltd was assigned, in-house, the operational management of the drinking water supply and effluent disposal services in the area concerned by way of a contract with the Water-Association with a duration of 20 years.

Municipal Holding Ltd is a company 100% owned by City C. It is the holding company of a group of several city-owned companies that are, inter alia, responsible for waste disposal and public transport. The integration of Waterfall Ltd in the corporate group is intended to allow for a cross-subsidisation and tax advantages to compensate losses of unprofitable companies within the group.

Municipal Holding Ltd owns 51% of the shares in Waterfall Ltd while the Water-Association holds 49% of these. The distribution of the profits of Waterfall Ltd, however, does not correspond to the distribution of the shareholding: They are not distributed pro-rata, but disproportionately to the benefit of Municipal Holding Ltd, which has an 80% interest in the profits of Waterfall Ltd. This (in terms of shareholding) asymmetrical profit-distribution is aligned to the amount of drinking water consumed in City C (80%) and in the surrounding municipalities (20%).

The contract between the Water-Association and Waterfall Ltd provides for a remuneration calculated on a total cost price basis on the basis of national public pricing law. Applying the Rules for the Determination of Cost Prices, the remuneration comprises the ‘cost reimbursement price’ and an imputed interest as well as profit margins. They are fixed at an amount of 3.5% a year.

There has never been a public procurement, bidding or tender procedure preceding either the formation of Waterfall Ltd or the attribution of the operational management services contract to Waterfall Ltd, even though Clearwater Ltd expressed its interest in continuing to perform the respective services by submitting an offer. In respect of both, the Water-Association invokes the in-house privilege pursuant to public procurement law, arguing the absence of any market.

III. Compatibility with European State Aid Law

According to Article 107(1) TFEU, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market. Thus, it is necessary that, on the upstream level, Municipal Holding Ltd (through the conditions of its shareholding in Waterfall Ltd, in particular the profit distribution),

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and/or, on the downstream level, Waterfall Ltd (because of the terms of the contract regarding the operational management services) benefit from the respective measure as an undertaking. This is the case if they receive an advantage at non-market conditions.

1. Municipal Holding Ltd and Waterfall Ltd as Undertakings

According to settled case law, an undertaking is defined as ‘any entity engaged in an economic activity, regardless of its legal status and the way in which it is financed’. Both Municipal Holding Ltd and Waterfall Ltd, are undertakings according to this definition, the latter carrying out an economic activity in the form of providing operational management services.

The fact that Municipal Holding Ltd does not itself provide goods or services (no economic activity) does not affect this finding: While an entity is not considered as an undertaking only by virtue of a (majority) shareholding in an undertaking providing goods and services on the market, it will indeed be considered as such if it is able to exercise controlling influence and does exercise controlling influence in respect of the conduct of the subsidiary on the market, just as Municipal Holding Ltd does in respect of the conduct of Waterfall Ltd.

In its preliminary ruling, the ECJ held that ‘the term undertaking must be understood as designating an economic unit […] even if in law that economic unit consists of several persons, natural or legal’. Accordingly, several legal persons can be considered as an economic unit and one undertaking for the purpose of European State aid law, provided that the holding company is able to exercise decisive influence and, in fact, exercises decisive influence in respect of the conduct of the subsidiary on the market. Only if the subsidiary takes its decisions independently, they will not be considered as an economic unit. However, Waterfall Ltd does not have any independent decision-making power vis-à-vis Municipal Holding Ltd. Since these criteria are equally applicable to a holding company or subsidiary that is publicly controlled, Municipal Holding Ltd and Waterfall Ltd are considered – in accordance with the ECJ’s rulings – an economic unit by virtue of the control it exercises over Waterfall Ltd. Thus, Municipal Holding Ltd is an undertaking within the meaning of Article 107 (1) TFEU that can be the recipient of an advantage.

2. Advantage Granted to Municipal Holding Ltd on the Upstream Level

Does the transaction in respect of the shareholding of Municipal Holding Ltd and the profit distribution conform with market terms, in spite of its character as an in-house procurement? The opportunity granted to Municipal Holding Ltd to acquire a majority shareholding of 51% in Waterfall Ltd and the – in terms of shareholding – disproportional profit distribution potentially confer an advantage upon Municipal Holding Ltd.

Under European State aid law, an advantage is any economic benefit which an undertaking could not have obtained under normal market conditions. An economic benefit has not been obtained under normal market conditions – inter alia – in the absence of any compensation or in the absence of an adequate compensation, in such that does not reflect the value of the economic benefit. Whether a transaction involving a public body conforms with normal market conditions or not, is assessed by the application of the market economy operator (MEO) test as the relevant method.

The notion of advantage is determined objectively only by the effects of a measure whereas neither the cause nor its intention are to be taken into account.

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8 Volker Emmerich in Ulrich Immenga, Ernst-Joachim Meinmäcker and Torsten Körber (eds), Wettbewerbsrecht, (5th edn, CH Beck 2014) vol 2 pt 1, ar 1011 TFEU para 3.

account.\(^{10}\) Thus, it is irrelevant that the measure is intended to allow for tax advantages because of cross-subsidisation within Municipal Holding Ltd in order to offset the loss-making public services rendered within the corporate group.

a. The Market Economy Operator Test

Except for the chance granted to Waterfall Ltd to benefit from the integration into the corporate group, Municipal Holding Ltd did not provide any consideration apart from the investment of 51% in Waterfall Ltd’s share capital. On the other hand, the profit distribution favours Municipal Holding Ltd. Additionally, the shareholding is highly valuable: The long-term contract ascribing the operational management services to Waterfall Ltd de facto functions as a guarantee of income, not least because the remuneration of Waterfall Ltd is calculated on a cost price basis that excludes losses and eventually guarantees profits.

In the light of this, it is doubtful that a market economy operator would have accepted a consideration amounting to no more than the capital investment of 51% if it had carried out this transaction.

A reliable method to establish that the transaction was in line with normal market conditions would be to carry out the transaction through a prior competitive, transparent, non-discriminatory and unconditional tender procedure.\(^{11}\) There is the presumption that the market price would correspond to the highest offer obtained by such a procedure.\(^{12}\) To that extent, the ECJ confirmed in its judgment in Land Burgengland v Commission\(^{13}\) the Commission’s position regarding the privatisation of State-owned companies.\(^{14}\) Even though the ECJ’s judgement was concerned with the privatisation of State-owned companies, the findings equally apply to the re-communalisation of services in the public interest: Just as a privatisation may grant an advantage to a private undertaking, its re-communalisation is liable to confer an advantage upon public undertakings.

In the case study, the awarding of the contract was not preceded by a competitive, transparent, non-discriminatory and unconditional tender procedure: Despite Clearwater Ltd showing its interest in continuing to perform the services in question, the market and any potential competition were excluded from the outset. Instead, a market economy operator would have involved the competitive market to obtain an offer as high as possible. This prompts the conclusion that the transaction did not take place under normal market conditions and involves the granting of an advantage.

b. Impact of the In-House Privilege

Does the awarding of the contract in-house make a difference? As a necessary consequence of awarding the shareholding in-house, no tender procedure was carried out in advance. In this regard, Municipal Holding Ltd claims that it follows from the legitimacy of awarding the contract in-house pursuant to the in-house privilege under public procurement law that the transaction is unobjectionable under European State aid law: Following the in-house transaction, there would not be a market in respect of a shareholding in Waterfall Ltd as the newly formed company. This precluded any possible distortion of competition a priori, rendering any recourse to a market price, for example, established by way of a competitive, transparent, non-discriminatory and unconditional tender procedure, redundant. The in-house privilege would rule out the existence of an advantage ex ante.

Yet, as exempting the transaction being subject to review under European State aid law, the argument falls short: The assumption fails to recognise that an in-house transaction only releases a public authority from the obligation under public procurement law to carry out a public procurement procedure in respect of the transaction in question. It does not do away with the obligation of complying with European State aid law that applies irrespective of the outcome under public procurement law for the following reasons:

The fact that the transaction was carried out in-house does not mean that there is no (potential) market.\(^{15}\) Such an assumption results from a circular


\(^{11}\) Commission Notice, para 84.

\(^{12}\) Joined Cases C-214/12 P and C-215/12 P and C-223/12 P Land Burgengland v Commission EC/EU/C:2013:682, paras 94 and 95.

\(^{13}\) ibid.


\(^{15}\) Unless there is a legal monopoly, alongside with other criteria: Commission Notice, para 188.
reasoning: As soon as a transaction is carried out in-house, the market and any (potential) competitors are excluded, as in the case of the case study. Even an in-house procurement may well have an impact on the market and may affect competition. Whether it is actually affected or not, is subject to European State aid law.

This aspect eventually turns upon the relevance of competition for the market in the context of European State aid law that the Commission made perfectly clear in paragraph 187 and 188 of its Notice on the notion of State aid (with reference to the relevant case law in the footnotes).

187. A measure granted by the State is considered to distort or threaten to distort competition when it is liable to improve the competitive position of the recipient compared to other undertakings with which it competes. For all practical purposes, a distortion of competition within the meaning of Article 107(1) of the Treaty is generally found to exist when the State grants a financial advantage to an undertaking in a liberalised sector where there is, or could be, competition.

188. The fact that the authorities assign a public service to an in-house provider (even if they were free to entrust that service to third parties) does not as such exclude a possible distortion of competition. However, a possible distortion of competition is excluded if the following cumulative conditions are met:
(a) a service is subject to a legal monopoly (established in compliance with EU law);
(b) the legal monopoly not only excludes competition on the market, but also for the market, in that it excludes any possible competition to become the exclusive provider of the service in question;
(c) the service is not in competition with other services; and
(d) if the service provider is active in another (geographical or product) market that is open to competition, cross-subsidisation has to be excluded.

This requires that separate accounts are used, costs and revenues are allocated in an appropriate way and public funding provided for the service subject to the legal monopoly cannot benefit other activities.

The Commission’s reference to ‘distortion of competition’ as one criterion in Article 107(1) TFEU implies that the character of a transaction as an in-house transaction does not affect the necessity of the assessment as to whether an economic transaction is carried out in line with normal market conditions. Rather, the criterion presupposes the existence of an advantage.

Likewise, the Commission already confirmed that the State aid rules are equally applicable to an in-house transaction, highlighting that the term in-house is a term concerning public procurement law while European State aid law forms part of competition law, and is, hence, not applicable. For the application of European State aid law, the economic character of the activity performed by the body would be decisive, irrespective of its nature or legal status. This reaffirms that the in-house privilege only allows a public authority to award a service without a prior procurement procedure, but does not affect the legal assessment under European State aid law.

c. Establishing Compliance with Market Conditions

Consequently, the existence of an advantage is not per se ruled out by the fact that a transaction was

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16 Commission Notice, paras 187 and 188.
19 Emphasis added.
20 A legal monopoly exists where a given service is reserved by law or regulatory measures to an exclusive provider, with a clear prohibition for any other operator to provide such service (not even to satisfy a possible residual demand from certain customer groups). However, the mere fact that the provision of a public service is entrusted to a specific undertaking does not mean that such an undertaking enjoys a legal monopoly.
21 Case T-295/12 Germany v Commission ECLI:EU:T:2014:675, para 158; Network Rail (State aid No N 356/2002) Commission Decision (2002) OJ C232/2, paras 75-77; for example, if a concession is awarded through a competitive procedure there is competition for the market.
22 At para 187 (emphasis added).
23 Commission, ‘Guide to the application of the European Union rules on state aid, public procurement and the internal market to services of general economic interest, and in particular to social services of general interest’ (Staff Working Document) SWD (2013) 53 final/2, no 44.
24 ibid.
carried out in-house. Only the actual execution of a competitive, transparent, non-discriminatory and unconditional tender procedure suffices to do so.\textsuperscript{26} Its omission does not.\textsuperscript{27} Therefore, even though the contract was awarded in-house, it remains necessary to establish conformity with market conditions where there is a potential market. Otherwise, the benefit cannot be considered to be obtained under normal market conditions.

In the absence of a previous competitive, transparent, non-discriminatory and unconditional tender procedure, the \textit{Water-Association} as public body has to establish compliance with normal market conditions through other methods,\textsuperscript{28} such as an independent (benchmarking) study. However, given the terms of the transaction, in particular the asymmetric profit distribution, it is rather unlikely that the \textit{Water-Association} is able to prove compliance with normal market conditions. A private market operator in a comparable position would not have considered itself as satisfied with the conditions of the transaction. Instead, it would have insisted on undertaking the transaction at different terms: It would at least have demanded a consideration amounting to more than a share capital investment of merely 51% for the reasons given above.\textsuperscript{29} Thus, the \textit{Water-Association} did not act the way a market economy operator would have. Since the transaction would not have been carried out under the same terms and conditions by a market economy operator, the intervention of the \textit{Water-Association} as public body is not in line with normal market conditions.

d. The Compatibility of the Cross-Subsidisation within the Corporate Group

In addition, the shareholding of \textit{Municipal Holding Ltd} in \textit{Waterfall Ltd} allows for a cross-subsidisation through a transfer of public resources, following the integration of \textit{Waterfall Ltd} into the corporate group. Without any evidence to the contrary, it generates a further economic advantage within the meaning of Article 107 (1) TFEU since the disproportional profit distribution functions as a source of funding for the (loss-making) municipal companies within the group. They eventually benefit from the compensation of overhead costs.

It is settled case law that transactions involving goods and services on preferential terms within public corporate groups may be regarded as constituting State aid within the meaning of Article 107 (1) TFEU if they are not justified on commercial grounds.\textsuperscript{30} The provision of shared services, such as the provision of logistical and commercial assistance,\textsuperscript{31} within a group by a public undertaking to a subsidiary that is organised as a private company and operates in a competitive market constitutes State aid within the meaning of Article 107 (1) TFEU if the price for these services falls short of what would have been demanded under normal market conditions. The Commission established the presumption that if public authorities or public undertakings provide goods or services at a price below market rates, or invest in an undertaking in a manner that is inconsistent with the market economy operator test [...], this implies foregoing State resources (as well as the granting of an advantage).\textsuperscript{32}

The provision of shared services thus only complies with normal market conditions, not conferring an advantage on an undertaking, if the price is determined on the basis of market conforming transfer prices.\textsuperscript{33} According to the Commission, compliance may be directly established either through specific market information available in respect of the concrete transaction where it is carried out under the same terms as between private market participants (\textit{pari passu}) or – only secondarily – through benchmarking.\textsuperscript{34} The burden of proof lies with the public authority and has not been discharged here.
e. Intermediary Conclusion

The *Water-Association* cannot rely on the in-house privilege under public procurement law to rule out the existence of an advantage. The in-house privilege only allows a public authority to contractually award a service without a prior procurement procedure, but has no effect on the legal assessment under European State aid law, having regard to which it is still up to the public authority to establish the transaction’s compliance with normal market conditions.

It is unlikely that the *Water-Association* is able to discharge its burden of proof. In the absence of any evidence on the contrary, the *Water-Association* is equally unable to rebut the presumption that the disproportional distribution of the shareholding grants a further advantage in the form of benefits generated by the possible cross-subsidisation.35

3. Advantage Granted to Waterfall Ltd on the Downstream Level

Is a calculation of a compensation in accordance with the rules for the determination of cost prices sufficient means to establish compliance with normal market conditions? *Waterfall Ltd* could have obtained an advantage in the form of remuneration under the contract assigning the operational management of the services to it. The nature of the transaction as an in-house assignment does not affect the assessment under European State aid law.36

An advantage within the meaning of Article 107 (1) TFEU could result from calculating the remuneration on a cost price basis, applying the Rules for the Determination of Cost Prices. The answer depends on whether a cost price calculation based on these rules provides for an appropriate assessment method to establish a transaction’s compliance with market conditions. Doubts as to the appropriateness exist in so far as a remuneration calculated on a cost price basis tends to be higher than one that was established by – for example – a competitive, transparent, non-discriminatory and unconditional tender procedure or other generally-accepted assessment methods. In these cases, competitive constraints ensure that it is close to the costs of an efficient performance of the services. The additional inclusion of imputed profits and allowances for risks on top of the cost price casts doubt on the cost price conforming with market-economy principles.37

a. The Rules for the Determination of Cost Prices as an Inappropriate Assessment Method

German public pricing law aims to ensure that prices for – inter alia – services under public contracts conform to market principles.38 It primarily applies to public contracts concerning the supply of goods or services, ie contracts awarded by the Federal Republic, the ‘Länder’, the municipalities or other corporations under public law.39 Preference is given to the market price over cost prices.40 A calculation based on cost prices is permitted only where a market price within the meaning of Regulation PR No. 30/53 is not available or where there is no or only restricted competition in respect of the good or service.41

‘Market Price’ within the meaning of Regulation PR No. 30/53 is commonly defined as the customary price for a marketable good or service.42 It conforms

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35 Obviously, the aid does not qualify as compensation for services of general economic interest (SGEi). Under the strictly defined conditions as set out in the Altmark judgement (Case C-280/00 Altmark Trans GmbH and Revisionspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH ECLI:EU:C:2003:415, [2003] ECR I-7747, paras 87 to 93), a compensation provided by the recipient undertaking does not constitute an advantage within the meaning of Article 107 (1) TFEU. Based on the criteria established in the Altmark judgement, the Commission defined the conditions under which an aid measure is compatible with the market in its Decision on the application of Article 106 (2) TFEU to State aid in the form of public service compensation (Commission Decision of 20 December 2011 on the application of Article 106 (2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, [2012] OJ L73/3 and the European Union Framework for State aid in the form of public service compensation (Commission, ‘European Union framework for State aid in the form of public service compensation’ (Communication) [2012] OJ C85/15) that are closely aligned to the Altmark test. The first criterion under both, the Decision and the Framework, is that there must be an entrustment act (section 2.3 of the SGEI Framework). Such an entrustment act is missing. In the absence of an entrustment act, the aid does not qualify as compensation for SGEi.

36 See s III.3.b.

37 This aspect is discussed in greater detail in s III.3.b.


39 Regulation PR No 30/53, ss 1 (1) and 2 (1).

40 Regulation PR No 30/53, s 1 (1).

41 Regulation PR No 30/53, s 5 (1).

with market conditions and, as regards European State aid law, serves as a means to directly establish compliance with market conditions according to the Commission’s Notice.\(^{43}\) A price for a service under a contract that corresponds to the market price can be said to conform with market conditions.\(^{44}\)

On the other hand, it is not to be compared to the competitive price.\(^{45}\) As a consequence, a price established through a procurement procedure may be regarded as the competitive price, but – in particular, where there is doubt whether it is customary – it does not necessarily constitute the market price.\(^{46}\) Furthermore, the finding of a ‘market price’ pursuant to German public pricing law requires the existence of actual competition.\(^{47}\) In both cases, i.e. where it is uncertain whether the price established through a procurement procedure is customary or where actual competition does not exist, the price under a public contract has to be determined based on cost prices in accordance with the Rules for the Determination of Cost Prices.

In the light of this, a calculation based on cost prices applies at a too early stage since they are applicable even though market-specific information, obtained by a competitive, transparent, non-discriminatory and unconditional tender procedure, exists. Even though such a procedure is not mandatory, in the event that the price established on a cost price basis diverges from the one obtained by such a procedure, a transaction does not comply with normal market conditions, despite its potential compliance with public pricing law.

Even in the absence of a tender procedure, a cost price calculation does not suffice to ensure the terms of a transaction being in line with market conditions: Firstly, the Rules for the Determination of Cost Prices allow at No 51 and 52 to include imputed profits in the cost price in order to compensate the general entrepreneurial risk. The amount of the imputed profit eventually depends on the undertaking’s total costs, incentivising the contractor to increase its total costs in order to generate a higher imputed profit;\(^{48}\) the higher the total costs, the higher the imputed profit. This completely contravenes market principles. A market economy operator would be keen to minimise its total costs to maximise its profits.\(^{49}\) Instead, a cost price-based calculation creates negative efficiency incentives: It destroys any incentives for municipal decision-makers to reduce costs as a cost reduction would inevitably lead to lower (imputed) profits. Moreover, negative efficiency incentives also stem from an inherent historical cost approach: The German Bundeskartellamt pointed out that the criteria under national public pricing law are orientated towards (past) costs, intending to determine an upper price limit.\(^{50}\) Competitive constraints which lead – pro futuro – to a cost reduction are not taken into account: The Rules for the Determination of Cost Prices do not provide for competitive parameters to be considered within the calculation. In particular, provisions demanding to take into account any advances in productivity or efficiency are missing. They ignore competitive efficiency incentives to reduce costs (in the long term) as well as depreciation periods that are likely to occur in the relevant market.

Last but not least, the assessment methods to establish a transaction’s compliance with market conditions are not conclusively enumerated in the Commission’s Notice. Other assessment methods are permitted. However, it is required that – inter alia – future expectations are taken into account and that a valuation has to be adapted to the current market conditions in the event of recent changes.\(^{51}\) This indicates that retrospective methods oriented backwards such as a cost price calculation will not meet the criteria to be fulfilled by the alternative assessment method. While the Commission has not expressed its view on this matter so far, this conclusion is essential.

For these reasons, the Rules for the Determination of Cost Prices and a cost price calculation thereupon
do not provide an appropriate method to ensure the compliance of the terms of a transaction with market conditions.52

b. The Existence of an Advantage and the
Unlawful Application of Public Pricing Law

In the case study, an advantage within the meaning of Article 107 (1) TFEU can hence not be ruled out by a calculation of the remuneration under the contract on a cost price basis. In spite of that, the (only exceptional) application of the cost price calculation was unlawful anyway because a market price existed, prohibiting any recourse to cost prices.53

Consequently, market compliance has to be established by other methods, such as an independent study or benchmarking. However, in the case study, compliance with market conditions cannot be established by the latter through comparing the terms of the transaction with the terms under which Clearwater Ltd currently provides its services: These terms do not provide an appropriate benchmark. In order to be an appropriate one, there has to be comparability in respect of the kind of operator concerned, the type of transaction and the market concerned.54 All factors that are relevant to the transaction have to be taken into account and, where appropriate, the benchmark has to be adjusted subsequently.55 Here, the past contract with Clearwater Ltd is not at stake.

Rather, the (potential) competition regarding the market for the operational management of the water management services for the period after Waterfall Ltd taking over the management tasks is concerned. To serve as a benchmark, it would thus be necessary to adjust it in this regard: Instead of being oriented to the past, it would need to take into account potential competition as well as competitive constraints and incentives to compete.

Had the transaction been carried out in the market through a competitive, transparent, non-discriminatory and unconditional tender procedure, the competitors would have faced competitive constraints, providing an incentive to closely align their offer to the costs of an efficient performance. This is even more so since the contract period amounts to 20 years. As a market economy operator is keen to reduce its (marginal) costs, in consequence, the compensation would have been much lower than it is under the contract with Waterfall Ltd. Consequently, it does not conform with market conditions.

Equally, the imputed profit and the addition for the imputed costs were fixed at a concrete rate. A fixed rate with no regard to the actual business risk does not allow for any allowances in respect of future developments of the business risk. De facto, the inclusion of an imputed profit and the addition for imputed costs take any entrepreneurial risk from Waterfall Ltd without even assessing the actual risk. Overall, they have not been determined in accordance with market standards.

As a consequence and in the absence of any evidence to the contrary provided by the Water-Association, the terms of the contract confer an advantage upon Waterfall Ltd.

c. No Qualification for a Compensation of SGEl

In the absence of an entrustment act, the remunera-
tion paid under the contract does not qualify for compensation under the rules on SGEl. In addition to the apparent absence of an entrustment act, there is no market failure in the market for operational management services regarding the supply of drinking water and effluent disposal: On the contrary, since 1992 Clearwater Ltd has performed its services consistently in a proper manner and on a high level and is still willing and able to carry out these services.

4. State Resources and Effect on Trade and Competition

The advantages conferred upon Municipal Holding Ltd and Waterfall Ltd are granted through State resources: The acquisition of a majority shareholding by Municipal Holding Ltd in Waterfall Ltd as well as the assignment of the operational management services to Waterfall Ltd under the contract followed the decisions of the members of the special public purposes association, the Water-Association, ie City C,

53 Regulation PR No 30/53, s 5 (1).
54 Commission Notice, para 99.
55 ibid.
financing the acquisition and paying the remuneration of Waterfall Ltd.

According to the Commission Notice on the notion of State aid, a distortion of competition within the meaning of Article 107 (1) TFEU is found to exist where the State grants a financial advantage to an undertaking in a liberalised sector where there is, or could be, competition. 56 The water management sector is a liberalised market, a legal monopoly being manifestly absent. There was potential competition regarding the provision of the operational management services which have formerly been rendered by Clearwater Ltd, irrespective of the nature of the transaction as an in-house procurement. 57 Rather, the nature and the execution of the transaction made it impossible for operators in other Member States to enter the liberalised market for the water management services in the area concerned: Competition has been thwarted by the public authorities through the in-house awarding of the operational management services to Waterfall Ltd and the shareholding to Municipal Holding Ltd. Therefore, the measures distort competition and have an effect on inter-state trade.

5. Summary of the Findings

Both Municipal Holding Ltd (on the upstream level through the conditions of its shareholding in Waterfall Ltd) and Waterfall Ltd (on the downstream level by virtue of the terms of the contract regarding the operational management of the services) benefit from the respective measure as undertakings, receiving a selective advantage. Since the other criteria are fulfilled, the measures constitute State aid. Neither the in-house privilege nor the calculation on a cost price basis have an impact on the legal assessment under European State aid law. Public procurement law and European State aid law are independent of each other. The legal admissibility of a project under public procurement law does not necessarily legitimise it in respect of European State aid law. The Rules on the Determination of Cost Prices do not reflect competitive and economic market standards and therefore do not constitute an appropriate method to establish conformance with market conditions.

IV. Conclusion

The article demonstrates that re-communalisation involves the risk of constituting illegal State aid. The risk is much greater than may have been initially thought. The easiest way to rule out the existence of illegal State aid is to carry out a competitive, transparent, non-discriminatory and unconditional tender procedure in advance. However, this does not match the interest of municipal authorities, aiming to re-communalise public services and to attend themselves to these tasks. It follows that the assignment of public services is usually realised through an in-house procurement. Yet, to prevent them from infringing European State aid law, awareness needs to be raised that it is a fallacy to assume that the admissibility under public procurement law or national public pricing law guarantees the admissibility of a project under European State aid law. Instead, re-communalisation schemes have to be examined having regard to several legal fields, each requiring an independent assessment.

56 Commission Notice, para 187.
57 The relevance of the in-house procurement was dealt with in s III.2.b.